United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

(42355)

ORIGINAL

75-6065

To be argued by
SAMUEL J. WARMS

United States Court of Appeals

FOR THE SECOND CIRCUIT

Case No. 75-6065

CITY OF NEW YORK,

Plaintiff-Appellant,

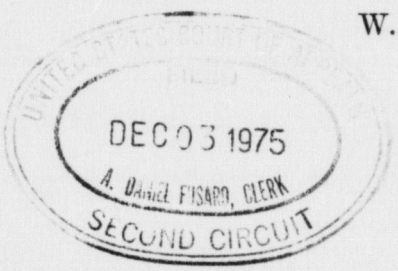
—against—

UNITED STATES OF AMERICA,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

APPELLANT'S BRIEF



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Statement

This is an appeal by the City of New York from a judgment of the United States District Court for the Southern District of New York (Cannella, D.J.), dated May 16, 1975 (27a)* which dismissed the appellant's complaint with prejudice.

Questions Presented

The following questions are presented on this appeal:

1. Whether the federal government may impose a tax for transportation by air on the City of New York in con-

* Unless otherwise indicated, references in parentheses are to pages in the Joint Appendix.

nection with travel by the City's officials and employees on governmental business.

2. Whether a complaint which alleges that that airline travel is in connection with and necessary to the accomplishment of required governmental duties, is sufficiently specific so that it can be deemed to include, and permit proof of, governmental duties which were uniquely governmental as well as an exercise of the delegated sovereignty of the State of New York.

3. Whether the tax in question, after the repeal of a provision exempting State and local governments, constituted a tax or a "user charge" where an amount equal to its proceeds was appropriated to the Airport and Airway Trust Fund but might be removed from that Fund by an act of Congress at any time.

The Complaint

Apart from the formal description of the parties, the substantive allegations of the complaint are as follows:

The City officials and employees who travel on official governmental City business are reimbursed by the City for their travel expenses and, since July 1, 1970, have paid and been reimbursed for, the excise tax imposed on their airline fares by I.R.C. §4261.

During the period July 1, 1970 to May 31, 1972, the City paid to the United States of America $80,500 for excise taxes levied pursuant to §4261 of the Internal Revenue Code.

On July 23, 1972, the City of New York filed a refund claim in that amount and on September 7, 1972, at the re-

quest of the United States Internal Revenue Service, filed amended claims for refund aggregating the same amount.

On January 19, 1973, the Internal Revenue Service notified the City by certified mail that its claims for refund were rejected.

Thereafter, on or about April 3, 1974, plaintiff commenced this action.

Statutory Background and Statutes Involved

(1) Background

Taxes on transportation by air have been a part of the federal tax system since 1941 (55 Stat. 721: Internal Revenue Code of 1939, §3469). The original imposition was denominated "a tax" and that denomination remains today (I.R.C. §4261). The provisions imposing and concerning the tax, as added to the 1939 Code, were amended a number of times and its original coverage of all forms of transportation was narrowed so that it now appears in I.R.C. §4261 as "a tax * * * for taxable transportation." I.R.C. §4262 defines "taxable transportation." as [certain] "transportation by air." The proceeds of this tax until 1970 became part of the general funds of the United States of America.

In 1970, the Congress enacted P.L. 91-258, 84 Stat. 219. Title I of that Act was called the "Airport and Airway Development Act of 1970" and, among other things, provided for the expansion and improvement of airports and airways systems. Title II of the Act was called the "Airport and Airway Revenue Act of 1970." Section 208 of Title II of the Act created an Airport and Airway Trust Fund and appropriated to that fund, not the amounts collected for the

transportation taxes, but amounts equivalent to the taxes received in the Treasury after June 30, 1970, from certain taxes including those in question here. Title II of the Act also made certain amendments to the Internal Revenue Code. One with which we are concerned was an amendment to §4261 of the Internal Revenue Code, increasing the tax on air transport of persons from 5% to 8% (P.L. 91-258, Title II, §203). Section 203 of the Act speaks of the "tax" on the transportation of persons by air, not the "charge".

Section 205 of Title II of the Act, in subdivision (a) (2), amended §4292 of the Internal Revenue Code. Section 4292 granted an exemption from the taxes imposed by §4261 (the Air Transportation Tax) and §4251 (the tax on telephone service) to the governments of any state, territory or their political subdivisions. The amendment of §4292 made by §205 of the Act simply struck out the number "4261", thus repealing an exemption which was partly an exemption of the states and their political subdivisions concerning their taxable proprietary non-governmental activities and partly a reiteration of the constitutional immunity from federal taxation which those governments enjoyed in the performance of their governmental activities (see p. 20, *infra*). A similar exemption for governmental entities had appeared in the text of the original tax statute, Internal Revenue Code of 1939, §3469(f).

The report of the Interstate and Foreign Commerce Committee of the House of Representatives, in discussing the removal of the state and local government exemptions, stated that "it did not seem appropriate to continue special exemptions for these governmental and educational organizations since this tax is now generally viewed as a user charge." (U.S. Code, Cong. & Ad. News, 91st Cong., 2d Sess. Vol. 2, 3091 (1970.)

Similar language appears in the report of the Senate Finance Committee [S. Rep. No. 91-706, 91st Cong., 2d Sess. 1 (1970-1 Cum. Bull. 386, 396)].

(2) Statutes Involved

The pertinent portion of I.R.C. §4261, subd. (a), before the 1970 amendment (P.L. 91-258, §203(a)), read as follows:

> "(a) Amounts paid within the United States.— There is hereby imposed upon the amount paid within the United States for taxable transportation (as defined in section 4262) of any person by air a tax equal to 5 percent of the amount so paid for transportation which begins after November 15, 1962."

That subdivision, after the 1970 amendment, read as follows:

> "(a) In general.— There is hereby imposed upon the amount paid for taxable transportation (as defined in section 4262) of any person which begins after June 30, 1970, a tax equal to 8 percent of the amount so paid. In the case of amounts paid outside of the United States for taxable transportation, the tax imposed by this subsection shall apply only if such transportation begins and ends in the United States."

Taxable transportation is defined in §4262 as follows:

> "* * * the term 'taxable transportation means—
>
> (1) transportation by air * * *."

Internal Revenue Code §4292, as amended by the 1970 Act (*id.*, §205(a)(2)), read as follows (the material in brackets was the only material deleted by the 1970 Act):

"4292. State and local governmental exemption

Under regulations prescribed by the Secretary or his delegate, no tax shall be imposed under section 4251 [or 4261] upon any payment received for services or facilities furnished to the Government of any State, Territory of the United States, or any political subdivision of the foregoing or the District of Columbia."

Section 208 of the Airport and Airway Revenue Act of 1970 (P.L. 91-258, §208, 84 Stat. 250), 49 U.S.C. §1742 reads, in pertinent part, as follows:

"SEC. 208. AIRPORT AND AIRWAY TRUST FUND.

(a) Creation of Trust Fund.— There is established in the Treasury of the United States a trust fund to be known as the 'Airport and Airway Trust Fund' (hereinafter in this section referred to as the 'Trust Fund'), consisting of such amounts as may be appropriated or credited to the Trust Fund as provided in this section.

(b) Transfer to Trust Fund of Amounts Equivalent to Certain Taxes.— There is hereby appropriated to the Trust Fund—

(1) amounts equivalent to the taxes received in the Treasury after June 30, 1970, and before July 1, 1980, under subsections (c) and (d) of section 4041 (taxes on aviation fuel) and under sections 4261, 4271, and 4491 (taxes on transportation by air and on use of civil aircraft) of the Internal Revenue Code of 1954;

(2) amounts determined by the Secretary of the Treasury to be equivalent to the taxes received in the

Treasury after June 30, 1970, and before July 1, 1980, under section 4081 of such Code, with respect to gasoline used in aircraft; and

(3) amounts determined by the Secretary of the Treasury to be equivalent to the taxes received in the Treasury after June 30, 1970, and before July 1, 1980, under paragraphs (2) and (3) of section 4071(a) of such Code, with respect to tires and tubes of the types used on aircraft.

The amounts appropriated by paragraphs (1), (2), and (3) shall be transferred at least quarterly from the general fund of the Treasury to the Trust Fund on the basis of estimates made by the Secretary of the Treasury of the amounts referred to in paragraphs (1), (2), and (3) received in the Treasury. Proper adjustments shall be made in the amounts subsequently transferred to the extent prior estimates were in excess of or less than the amount required to be transferred."

POINT I

A political subdivision of the state which exercises governmental functions may not be subjected in the performance of those functions to a federal tax.

(1)

The first case in which the United States Supreme Court held that there was a reciprocal immunity from taxation between the federal and state governments was *Collector* v. *Day,* 78 U.S. (11 Wall.) 113 (1870). The case came more than 50 years after the landmark decision in *M'Culloch* v. *Maryland,* 17 U.S. (4 Wheat.) 316 (1819). The principle of

intergovernmental immunities was thereafter applied alike to federal and state instrumentalities except that the immunity of the states was narrowed when the activities which were subject to federal tax were of a private non-governmental character [*South Carolina* v. *United States,* 199 U.S. 437 (1905); *Ohio* v. *Helvering,* 292 U.S. 360 (1934) (taxes on state liquor stores); *Allen* v. *Regents,* 304 U.S. 439 (1938) (admissions tax on state university football games); *New York* v. *United States,* 326 U.S. 572 (1946) (tax on mineral water)] or the tax burden was indirect and remote [*Helvering* v. *Gerhardt,* 304 U.S. 405 (1938); *Graves* v. *N.Y. ex rel. O'Keefe,* 306 U.S. 466 (1939) (income taxes on state and federal employees); *James* v. *Dravo Contracting Co.,* 302 U.S. 134 (1937) (tax on receipts of government contractor); *Alabama* v. *King & Boozer,* 314 U.S. 1 (1941) (sales tax on government cost-plus contractor).

Even in these latter cases, the Supreme Court invariably adverted to the immune status of certain state governmental activities. The Court said in *Ohio* v. *Helvering* (292 U.S., at p. 368):

> "* * * the immunity of the states from federal taxation is limited to those agencies which are of a governmental character * * *."

And in the Saratoga Springs case, *New York* v. *United States, supra,* from the *dicta* of which the Court below erected its requirements for immunity, Mr. Justice RUTLEDGE stated in his concurring opinion (326 U.S. at p. 584):

> "All agree that not all of the former immunity is gone."

While *Collector* v. *Day,* 78 U.S. (11 Wall.) 113 (1870), involved the salary of a State judge, the immunity principle of the case was not disturbed by the fact that in a later era the Supreme Court held that salaries of State employees were subject to federal income tax. *Helvering* v. *Gerhardt,* 304 U.S. 405 (1938). Nor was the principle of *M'Culloch* v. *Maryland, supra,* which established federal immunity, affected by that Court's holding that federal employees' salaries were subject to State income taxes. *Graves* v. *N.Y. ex rel. O'Keefe,* 306 U.S. 466 (1939). Those cases simply held that income tax burdens, when applied to the government salaries of individuals, were too remote to partake of the reciprocal immunities of their governmental employers.

Actually, there has been some narrowing of the reciprocal immunities, as we have indicated. Writers on the subject have described this narrowing but have never suggested that the immunities of a state and its political subdivisions have been erased. See Powell, *The Waning of Intergovernmental Tax Immunities,* 58 Harv. L. Rev. 633 (1945); Powell, *The Remnant of Intergovernmental Tax Immunities, Id.,* 757.

Actually, Professor Powell's articles bear titles which provide fuel for the opinion of the Court below (19a, f.n. 9), but their substance paints a picture far less broad and extensive than the titles would imply. For the most part, Professor Powell's articles discuss the pre-1945 inroads made upon the doctrine. Those inroads consisted of the taxation of government salaries [*Helvering* v. *Gerhardt,* 304 U.S. 405 (1938); *Graves* v. *N.Y. ex rel. O'Keefe,* 306 U.S. 466 (1939)], other taxes which had only an indirect bearing on the governments involved and were levied

on the taxpayer where the economic, but not the tax burden fell upon the government [*Alabama* v. *King & Boozer*, 314 U.S. 1 (1941); *James* v. *Dravo Contracting Co.*, 302 U.S. 134 (1937); *Curry* v. *United States*, 314 U.S. 14 (1941)], cases involving proprietary activities [*Allen* v. *Regents*, 304 U.S. 439 (1938); *New York* v. *United States*, 326 U.S. 572 (1946)] and other similiar holdings.

(2)

The Court below viewed the last cited case, *New York* v. *United States, supra*, as "[a] particularly crushing blow to the pre-existing doctrine * * *" (19a-20a). It is, in fact, no such thing. Justice FRANKFURTER, who announced the judgment of the Court, delivered a minority opinion in which Justice Rutledge joined. Before setting up the standards for immunity which he felt were desirable, and which the Court below adopted in its opinion, he said (326 U.S. at pp. 574-575):

> "On the basis of authority the case is quickly disposed of. When States sought to control the liquor traffic by going into the liquor business, they were denied immunity from federal taxes upon the liquor business. *South Carolina* v. *United States*, 199 U.S. 437; *Ohio* v. *Helvering*, 292 U.S. 360. And in rejecting a claim of immunity from federal taxation when Massachusetts took over the street railways of Boston, this Court a decade ago said: 'We see no reason for putting the operation of a street railway [by a State] in a different category from the sale of liquors.' *Helvering* v. *Powers*, 293 U.S. 214, 227. We certainly see no reason for putting soft drinks in a different constitutional category from hard drinks. See also *Allen* v. *Regents*, 304 U.S. 439."

That quotation was sufficient to dispose of the case on its facts for, clearly, the subject taxed was a non-governmental engaging in the production of mineral water. But Justice FRANKFURTER went on because he felt that new criteria were in order. Justice Rutledge, alone, concurred in this opinion. Justice Stone wrote a concurring opinion for a plurality of the Court.* He differed sharply with Justice Frankfurter's formula for immunity, namely, that the tax would be valid against a state government if it were a general non-discriminatory tax and if the subject of a tax were not uniquely governmental. Justice STONE set up a different formulation which, in essence, while not requiring such a tax to be discriminatory against the government, required it to be one which would so affect the State as to interfere unduly with the performance of its sovereign functions of government.

Neither the criteria for immunity postulated by Justice Frankfurter nor those postulated by Justice Stone had the support of a majority of the Court. Hence, the only rule to be gleaned from *New York* v. *United States* is that the proprietary activity of obtaining, bottling and selling mineral waters by a state, is subject to a federal excise tax. That rule is not new but was announced in *South Carolina* v. *United States,* 199 U.S. 437 (1905) and followed in *Ohio* v. *Helvering,* 292 U.S. 360 (1934); *Helvering* v. *Powers,* 293 U.S. 214 (1934), and *Allen* v. *Regents,* 304 U.S. 439 (1938).

In the work entitled, THE CONSTITUTION OF THE UNITED STATES of AMERICA, prepared pursuant to P.L. 91-589, 84 Stat. 1585; 2 U.S.C. §168, by the Congressional Research

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* Justices Reed, Murphy and Burton concurred with Justice Stone; Justice Jackson took no part in the case.

Service, Library of Congress (1973), in treating of the scope of State immunity from federal taxation, the authors state (pp. 131-132):

> "Although there have been sharp differences of opinion among members of the Supreme Court in recent cases dealing with the tax immunity of state functions and instrumentalities, it has been stated that 'all agree that not all of the former immunity is gone.' Twice, the Court has made an effort to express its new point of view in a statement of general principles by which the right to such immunity shall be determined. However, the failure to muster a majority in concurrence with any single opinion in the more recent of these cases leaves the question very much in doubt.
>
> * * * * *
>
> The second attempt to formulate a general doctrine was made in *New York* v. *United States,* where, on review of a judgment affirming the right of the United States to tax the sale of mineral waters taken from property owned and operated by the State of New York, the Court reconsidered the right of Congress to tax business enterprises carried on by the States. Justice Frankfurter, speaking for himself and Justice Rutledge, made the question of discrimination *vel non* against state activities the test of the validity of such a tax. They found 'no restriction upon Congress to include the States in levying a tax exacted equally from private persons upon the same subect matter.' In a concurring opinion in which Justices Reed, Murphy, and Burton joined, Chief Justice Stone rejected the criterion of discrimination. He repeated what he had said in an earlier case to the effect that '. . . the

> limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax . . . or the appropriate exercise of the functions of the government affected by it.' Justices Douglas and Black dissented in an opinion written by the former on the ground that the decision disregarded the Tenth Amendment, p[l]aced 'the sovereign States on the same plane as priv[a]te citizens,' and made them 'pay the Federal Government for the privilege of exercising powers of sovereignty guaranteed them by the Constitution.'"

The Court below purported to apply the conditions set forth for immunity in both the opinions of Justice FRANKFURTER and Justitce STONE in *New York* v. *United States*, stating (24a):

> "Clearly, the excise tax imposed by §4261 of the Code is nondiscriminatory in nature. All users of air transportation facilities (with the limited exception of an international organization of the Red Cross) are equally subject to this tax. We cannot perceive any undue interference with the soverign functions of City government as the result of its being compelled to contribute to the federal tax coffers in this particular instance."

In our view, the Court erred in two respects. Firstly, there was no Supreme Court authority for the application of either the formulations of Justice FRANKFURTER or Jus-

tice STONE in *New York* v. *United States*. The case should properly have been viewed merely as a case involving purely proprietary activities. Secondly, the Court below erred in concluding that the tax in question would not, in Justice Stone's words, "impair the sovereign status of the State * * * " (326 U.S. p. 587). It is true that the tax was nondiscriminatory in the sense of Justice FRANKFURTER's formulation in that it applied to private persons as well as the City. But Justice STONE's formulation did not require that the tax be discriminatory for he held that "nondiscriminatory-taxes which, when laid on the State, would nevertheless impair the sovereign status of the State * * * " (*ibid.*, p. 587), were impermissible. In holding that the tax did not impair the State's or City's activities which partook of sovereignty, and also in holding that those activities were not uniquely governmental,* the Court overlooked the fact that the "governmental City business" pleaded in the complaint (5a) might well—as it actually does—include such uniquely governmental exercises of sovereignty as the travel involved in extraditing persons from other states by police officers and others, many of whom are assigned to the various District Attorneys' offices. It also overlooks the travels of the Mayor and his staff on direct City business with the state and federal governments and legislative bodies relating to legislation and subsidies. It overlooks many other activities, of which there is no record proof since the case has not been tried, which are indeed uniquely governmental and partake of an exercise of sovereignty.**

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* Justice Frankfurter had excepted from his rule, uniquely governmental activities (326 U.S. at p. 582).

** While there is no record evidence of these activities, they are properly the subject of judicial notice [*Brown* v. *Piper*, 91 U.S. 37 (1875); *Matter of Clement* (*Hunt Certificate*), 132 App. Div. 598 (1909)], and of quantitative proof in further proceedings.

This kind of detail is more properly the subject of interrogatories under Rule 33 of the Federal Rules of Civil Procedure.

We do not believe that the City is completely restricted in its immunity by the guidelines set forth in either Justice STONES's or Justice FRANKFURTER's opinions. These are and remain *dicta* until the Supreme Court, in a proper case, adopts them, or one of them, as its own. However, we confidently feel that under the complaint as it stands, we would be entitled and able to prove and recover tax with respect to those items which clearly meet the rigid formulation of Justice FRANKFURTER, and the more flexible formulation of Justice STONE. It is true that both Justices were seeking a way out of the increasing difficulties which inhere in trying to classify activities either as governmental or proprietary. Much of what was proprietary years ago has become clearly governmental by this time and the effort of the two Justices to brush aside the thicket of inconsistencies previously constructed by the Supreme Court is indeed commendable.

However, just as the Court below felt that we did not pass muster when tested by either of these formulations, we feel that, on the contrary, we easily met the requirements of both opinions.

POINT II

Even if the rigid criteria required by the District Court reflect the present state of the law, the complaint is sufficiently specific to bring it within the requirements of those criteria. If it were not, the District Court should have granted leave to serve an amended complaint instead of granting an outright dismissal. In the absence of such permission, this Court should reverse or vacate the judgment and permit an amended complaint to meet those criteria.

The Federal Rules of Civil Procedure fully support our view that the complaint's allegation of "governmental City business" (5a) is sufficient to encompass the kind of uniquely governmental exercises of sovereign power involved in this case.

Subdivision f of Rule 8 of the Federal Rules of Civil Procedure requires that "[a]ll pleadings shall be so construed as to do substantial justice." Form number 8 in the Appendix of Forms contained in those Rules (the form fitting this case most closely) in accordance with the mandate of Rule 84 that it be "intended to indicate the simplicity and brevity of statement which the rules contemplate", would seem to lend force to our contention for it is a simple statement of indebtedness by the defendant. In essence, our case too is an action for money had and received.

Rule 8 provides that "a pleading shall be simple, concise, and direct" and that "[n]o technical forms of pleading or motions are required." Accordingly, we believe that the complaint in this case fully states "a claim upon which relief can be granted * * *." (Rule 12b)

Should this Court feel that we are wrong in our assertion that the complaint is sufficient to meet the criteria contained in the *dicta* of *New York* v. *United States,* and that those *dicta* reflect the present state of the law and, therefore, that the complaint should be deemed insufficient, the Court below or this Court should permit the City to serve an amended complaint in which it pleads in detail the facts showing that the criteria in those *dicta* have been met and are present in the case.

We recognize that Rule 15 of the Federal Rules of Civil Procedure contemplates amending the complaint before appeal and that some cases hold or recognize that one must make such a motion to vacate the judgment and move to amend before appealing. *Foman* v. *Davis,* 371 U.S. 178 (1962); *United States* v. *Hougham,* 364 U.S. 310 (1960), reh. den., 364 U.S. 938 (1961). But that rule has been construed in the case last cited as "designed to facilitate the amendment of pleadings except where prejudice to the opposing party would result" (364 U.S. at p. 316). And in *Conley* v. *Gibson,* 355 U.S. 41 (1957), the Supreme Court said (p. 48):

> "The Federal Rules reject the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits."

Moreover, the case at bar presents a somewhat extraordinary situation, quite different from those presented in the cases cited. Our position is that the City's complaint is adequate and that the judgment dismissing it should be reversed. Since we feel that the complaint states a claim

on its face, it would have been foolhardy indeed to move to amend it and perhaps waive the City's right to contend for a broader immunity. At this point, substantial justice requires that, if this Court should disagree with our view, leave to amend should be granted. Rule 15 requires that "leave shall be freely given when justice so requires." We can think of no better case for the application of these words of the Rule, if indeed it needs to be invoked.

POINT III

The tax on transportation by air was originally enacted as a tax and remained a tax despite the characterization of it as a "user charge" in reports of the congressional committees which recommended the removal of governmental exemptions.

(1)

The Court below based its decision entirely on the constitutional issue. But the United States had also relied on the case of *State of Texas* v. *U.S.*, 72-2 U.S. Tax Cas., ¶16,048, at 86,128 (W.D. Tex., 1972), aff'd mem. 73-1 U.S. Tax Cas., ¶16,085, at 81,394 (5 Cir., 1972). The Court in a footnote (*id.* 25a-26a) concluded that although the case related mainly to the "user charge" issue, it contained *dicta* which followed the "nondiscriminatory" test of Justice Frankfurter in *New York* v. *United States.*

Because we believe that the appellee will urge the *Texas* case as a precedent, we shall discuss it now instead of waiting until a reply brief is called for.

Certainly, *State of Texas* v. *U.S.* appears to support the government's argument in our case and appears to

be directly in point. It involved the transportation taxes paid by and reimbursed to employees of the State of Texas. While the case may be persuasive authority for this Court, we think that it was erroneously decided. It can also be demonstrated that the *Texas* case is not illuminating on the issue of whether the Transportation Tax is a tax or a charge. In our case, the government's argument has been that by reason of the Airport and Airway Trust Fund, the proceeds of the tax are used for the construction of airport facilities from which the taxpayer benefits. Accordingly, it has used the language of the congressional committees which recommended removal of the exemption, and calls the tax a "user charge." The City, on the contrary, urges that the tax in question is truly a tax and not a charge at all.

In the *Texas* case, counsel for the State of Texas did not resist this inaccurate characterization of the tax. On the contrary, he expressly agreed in his Stipulation of Facts that:

> "2. The excise taxes referred to in paragraph 1, *supra,* represent a user charge imposed pursuant to Section 4261 of the Internal Revenue Code of 1954, as amended." (72-USTC at p. 86129)*

In short, Texas stipulated its case away and the Court simply adopted the stipulated matter. The affirming Court of Appeals rendered only a *per curiam* affirmance. It is true that the last paragraph of the District Court's opinion in the *Texas* case contains a *dictum* to the effect that even as a tax the imposition would not be an interference with sovereignty. Not only is this *obiter* but it is merely a dogmatic statement without any supporting reasoning.

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* Copies of this stipulation will be furnished to the Court.

(2)

The real nub of the instant controversy is whether or not the 1970 legislation made taxable what was theretofore immune. There is no doubt that the amendment of the exemption section, Internal Revenue Code §4292, rendered taxable those activities of state and local governments which were proprietary and nongovernmental in nature. Because the immunity of governmental activities from federal taxation has its origin in the Constitution, not in any statute, it follows that the repeal of the exemption of state and local governments by the 1970 Airport and Airway Revenue Act is of little significance in this case. The exemption statute consisted of a true exemption so far as nongovernmental activities were concerned, but was merely a reiteration of the constitutional immunity when governmental activities were involved. This kind of exemption is not infrequent in the Internal Revenue Code.*

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* The question of taxability of interest on state bonds has not been raised judicially even though that interest may be analogized to the salaries of state employees, because of exemption by Internal Revenue Code §103 and its predecessors, which go back to the first Revenue Act enacted after the adoption of the 16th Amendment (Revenue Act of 1913, 38 Stat. 114, 168, §II-B). While §103 had generally been considered a reiteration of the implied constitutional immunity [see 1 Mertens, Law of Federal Income Taxation, §8.17 (1962); Burdick, The Law of the American Constitution, 18 *et seq.*], history shows it to have been born of a fear that the immunity had been removed by the 16th Amendment because it authorized "taxes on income, *from whatever source derived.*" Later cases held that the 16th Amendment merely removed the requirement of apportionment from an income tax. See *Evans* v. *Gore*, 253 U.S. 245, 259 (1920). The amendments made to §103 by the Tax Reform Act of 1969, which, among other things, provided for the taxation of interest on state bonds when they were issued as part of an arbitrage transaction (P.L. 91-172, 83 Stat. 487, §601a), may result in the raising of a constitutional issue. (Italics supplied.)

The amendment of the exemption section could not possibly destroy the sovereign immunity of the states which stems from the federal Constitution and the reciprocal intergovernmental immunities which the Supreme Court had determined to be the progeny of that Constitution.

But the question with which we must deal is whether the creation by the 1970 legislation of an Airport and Airway Trust Fund, which was supported by appropriations reflecting the amounts of the taxes collected, converted what had for years been a tax, into a charge.

We shall pass over the fact that the taxes levied by I.R.C. §4261 do not go into that trust fund but that there is an appropriation of an amount equal to those taxes [P.L. 91-258, §208, 84 Stat. 250 (49 U.S.C. §1742)]. We do not wish to base our argument here on the niceties of form by which the trust fund is supported.

We would argue, rather, that even if the tax receipts did go into that trust fund, they are nevertheless receipts of taxes and not of charges. They were originally enacted in 1942 as taxes, and they remained as taxes. It is only with the advent of the 1970 legislation that the government has sought to change their nature. But the language pursuant to which they are imposed was not substantially changed by that legislation. The law still calls them taxes. They are still part of the Internal Revenue Code and are subject to all that Code's applicable procedural provisions, most of which call the imposts taxes. To call them charges when nothing was done to the statute imposing them to change their character from the taxes which they were is utterly unrealistic.

The idea of calling the tax a charge, stems from the statement made in the report of the House Committee.

That statement said (U.S. Code Cong. Ad. News, 91st Cong. 2d Sess., Vol. 2, 3091 (1970)):

> "* * * this tax is *now* generally viewed as a user charge." (Italics supplied)

The lack of foundation for this statement is matched only by its inaccuracy. It was plainly inaccurate because it was made before the 1970 legislation was passed, before the trust fund was set up, before the Internal Revenue Code was amended and yet it said that the tax which had always been a tax is now; *i.e.*, at the time of the report, viewed as a charge. The statement conflicts with the whole super-structure of the government's present argument which is to the effect that the legislation converted what had been a tax into a charge. The Committee's words indicate that it had always been a charge or, at least, it had come to be considered a charge, even before there was a trust fund.

This characterization of the tax by the Committee seems to have been but a fleeting thought, for in the report in which it was contained, the Committee forgets about its supposed character and speaks of the tax as a "tax" on at least 150 separate occasions [U.S. Code, Cong. Ad. News, 91st Cong., 2d Sess., Vol. 2, 3076 to 3125, (1970)].

It is well known that congressional committees have a way of larding their reports with statements which will be grasped by the courts in interpreting the statutes on which they are reporting. Mertens states that sometimes, as here, these reports contain "self-serving statements as to the intent behind the law" (see Mertens, Law of Federal Income Taxation, Vol. 1, §3.29, f.n. 63).

But if the committees and the Congress intended to convert what had been a tax into a "user charge", it seems to us that they would have done so by appropriate language in the statute which they were considering and passing, not in the committee reports. We feel that an unambiguous statute is to be interpreted through the language which it employs and that the language employed in fashioning the taxing provision in issue is the language of taxation and no different from the many other sections of the Internal Revenue Code which impose various other taxes.

There are situations in which a true charge is imposed. The City of New York, for example, has since 1962, imposed an annual vault charge (Admin. Code of the City of New York, Chapt. 46, Title Z). The charge is made to owners of property abutting a vault which is used and maintained by them under a City street. There is a direct relationship between the charge and something furnished by the City. The charge is called a charge and not a tax in the law imposing it (*id.* §Z46-2.0).

In *First Nat. City Bank* v. *City of N.Y. Finance Administration,* 44 AD 2d 774 (1st Dept., 1974), mot. for lv. to app. den., 34 NY 2d 519 (1974), the plaintiff, a national bank, had claimed immunity under the appropriate federal statute from the vault charge. The courts upheld the charge because it was not a tax prohibited by federal law.

(3)

All taxes are imposed for the purpose of defraying the cost of government and that cost is always incurred for the benefit of taxpayers and the general public. In a sense, consequently, all taxes can be said to be imposed for services rendered and to be rendered. Under the theory adopted by the government in this case, the remaining vestiges of

the sovereign immunity enjoyed by the states and localities could be wiped out by the simple expedient of tying in the proceeds of each tax with and earmarking them for, a particular activity of government. To the extent that a tax defrays more than one kind of governmental expense, it could be by statute directed to defraying the costs of specified categories of expense. Indeed, under such a view, the City of New York might fragmentize its real estate levy ascribing appropriate portions to police and fire protection and bill the federal government for those services.

In the present case, there is no guarantee that the trust fund which is enriched by the taxes in question will remain dedicated to the purposes for which it presently is devoted. Diversion has, in fact, happened with the so-called highway trust fund (funded by, among others, the gasoline tax) and there are movements looking toward a greater diversion of the moneys in that trust fund toward mass transit.

The Highway Trust Fund was created by §209 of P.L. 84-627, June 29, 1956, c. 462, Title II, 70 Stat. 397; 23 U.S.C. §120 f.n. The earliest diversion of funds from the Highway Trust Fund for non-highway purposes, came when P.L. 91-605, Title I, §111(a), Dec. 31, 1970, 84 Stat. 1719; 23 U.S.C. §142, directed their use in aid of the construction of preferential bus lanes, loading areas and other facilities, including parking facilities for mass transportation purposes. The pretext here was that these were allied to highway purposes but the next step was to permit the Secretary of Transportation, beginning in July of 1974, to use the funds for the purchase of buses and, beginning in 1975, to use the Fund for the construction and improve-

ment of rail facilities and the purchase of rolling stock. P.L. 93-87, Title I, §121(a), Aug. 13, 1974, 87 Stat. 259; 23 U.S.C. §142.

We can see from this that the original dedication of tax receipts to a particular purpose benefiting the taxpayer is easily thwarted at the will of the Congress and if this may be done, it is hard to see how those taxes can be considered as user charges for the benefit of the taxpayer.

This kind of diversion of so-called trust funds has already been proposed for the Airport and Airway Trust Fund to which the City's taxes have been appropriated. The New York Times of August 14, 1975, at page 43, carried an article indicating that major banks and insurance companies owning a large amount of airline securities sought a $500,000,000 subsidy for the airlines out of the Airport and Airway Trust Fund. Specifically, the plan sought to divert 50% of the current taxes on passenger fares for 1975 and the first half of 1976.

There is no showing that any portion of the fund in question has been used for the benefit of the passengers who paid the taxes. To them it means, at the very most, an illusory promise for possible airport improvement in the future. There is no demonstration that any service is being rendered them at the time of flight.

(4)

There is, in the case at bar, no indication that the amount of the taxes to be collected are commensurate with or in any way related to the services or benefits which the taxpayer presumably will receive. In two recent cases, reported under the title of *Evansville Airport* v. *Delta Air-*

lines, 405 U.S. 707 (1972), it was held that states and their political subdivisions which operated airports might impose a head tax on passengers departing from those airports. Normally, such taxes would have been an unconstitutional impairment of the right to travel under the Privileges and Immunities Clause (U.S. Const., Art. IV, §2), or the Commerce Clause (U.S. Const., Art. I, §8, Cl. 3). *Crandall* v. *State of Nevada,* 73 U.S. (6 Wall.) 35 (1867), and the *Passenger Cases,* 48 U.S. (7 How.) 283 (1849).

However, the Court upheld the charges as imposts for the services provided to the passengers at the airport, for the maintenance of which the governmental units were responsible. But in upholding these imposts, which were to be used for the improvement and maintenance of the airports, the Court was careful to find that the charges made were a fair, albeit imperfect, approximation of the value of the use of the facilities by those upon whom they were imposed. In short, the charges were found to be not excessive in relation to the costs incurred in providing the services to which they were related.

We believe that even were the tax involved here to be considered a charge rather than a tax, it would not be sustained as an infringement of sovereign immunity without a showing that the amount of the so-called charges bore a fair relationship to the benefits received by the governmental taxpayers. To sustain its tax in this case, there must be some factual background of which the Court can take judicial notice to show the commensurateness of the services rendered and the charges imposed. We are not, in this aspect of our argument, saying that if a proper relationship can be shown, the tax in issue can be upheld. For all of the reasons set forth in this brief,

it cannot be upheld as a charge because it was not imposed as a charge. We are merely pointing out that even if the Court were to find it to be a charge, it would still have another barrier to hurdle before the City can be held liable.

(5)

The government has also argued that the 1970 legislation was an exercise of the governmental power over interstate commerce. It pointed out that the commerce power is stronger than the taxing power when it intrudes upon the sovereignty of the states. Be this as it may, it is clear that the tax on transport by air is not an exercise of the commerce power. It is what it should be, a simple exercise of the power of taxation by the federal government. This is clear when we look at the taxing statute. The tax imposed by §4261 of the Internal Revenue Code is not limited to interstate flights. It is imposed on any transportation by air "which begins in the United States * * * and ends in the United States" (I.R.C. §4262). A flight from New York City to Albany is not interstate commerce but it is taxable. We think the notion that this tax is founded on the commerce power is misguided.

CONCLUSION

The judgment of the District Court should be reversed or, if it is not, the plaintiff should be permitted to serve and file an amended complaint.

December 3, 1975

Respectfully submitted,

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